ST 00-2
Tax Type: **Sales Tax**
Issue: **Audit Methodologies and/or Other Computational Issues**
Books and Records Insufficient

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

DEPARTMENT OF REVENUE	) 99 ST 0000
STATE OF ILLINOIS	) 0000-0000
	) NTL #SF 9900000000000
v.	)
	) Mimi Brin
"CASABA RESTAURANT",	) Administrative Law Judge
	)
Taxpayer	)

RECOMMENDATION FOR DISPOSITION

Appearances: Charles Nixon for "Casaba Restaurant"; John Alshuler, Special Assistant Attorney General for the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to a timely protest by "Casaba Restaurant" ("Casaba" or "Taxpayer") to Notice of Tax Liability SF 9900000000000 ("NTL") issued by the Illinois Department of Revenue ("Department") on February 16, 1999. The Notice included liability determined for Retailers' Occupation Tax and related taxes, plus late filing penalty, a fraud penalty and interest computed to the date of the NTL. The basis of the NTL is that taxpayer underreported its gross receipts for the period of December 1995 through June 1998 ("Tax Period"). A hearing in this matter

was held whereat the Department auditor, Charles Fountain ("Auditor" or "Fountain") and "Akio Watanabe", one of "Casaba's" owners, appeared as witnesses.[1]

Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department as to the tax liability and the late filing penalty. It is further recommended that the fraud penalty shall be revised to reflect a penalty for negligence pursuant to §3-5 of the Uniform Penalty and Interest Act. 35 ILCS 735/3-5 In support of this recommendation, I make the following findings of fact and conclusions of law:

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Audit Correction and/or Determination of Tax Due, showing an assessment for tax, a late filing penalty and a fraud penalty for the tax period of 12/1/95 to 6/30/98. Department Gr. Ex. No. 1; See also NTL, Department Gr. Ex. No. 1; 11/9 Tr. pp.10-11
2. Taxpayer operated, in Illinois, as a restaurant opened for lunch and dinner. Department Gr. Ex. No. 1 (Audit Correction and/or Determination of Tax Due, NTL); 11/9 Tr. pp. 13-16
3. The restaurant included a bar area, a sushi bar and an area where customers sat to eat their lunches or dinners. 11/9 Tr. p. 15
4. The auditor arrived at "Casaba's" total sales for the tax period by multiplying an average vending price (meal price) by the number of

[1] The hearing in this cause was commenced on November 9, 1999. Because of concerns regarding the discovery conducted by the parties, I continued the hearing to December 1. I cite to the transcript of the

chopsticks purchased by the taxpayer from "Chopsticks, Inc.", allowing for a 20% ending inventory. 12/1 Tr. pp. 9, 13, 14

5. In order to arrive at the average meal price, the auditor used a preprinted menu found at the counter that was offered free to anyone. 12/1 Tr. pp.15-16; Taxpayer Ex. No. 10 His calculation was based upon the average of full lunches, dinners, carry-outs and sushi bar items. 12/1 Tr. pp. 20-23

6. In making his determination of the average meal price, the auditor did not take into account any meal promotions, as he was not provided any documentation regarding them. 12/1 Tr. p. 26, 46-51; Taxpayer Ex. Nos. 5C, 5D[2], 6

7. The auditor was aware of five or six employees at the restaurant each time the auditor was on the premises. 12/1 Tr. p. 29 He included in his total sales calculations possible giveaway meals for the employees as part of the 20 per cent inventory allowance. 12/1 Tr. p. 31

8. The auditor used the taxpayer's chopsticks purchases as part of his sales calculations because chopsticks were used in place of silverware for diners. 12/1 Tr. p. 30 Consideration for broken chopsticks and chopsticks used by employees for their meals were included in the 20 per cent allowance included by the auditor. 12/1 Tr. pp. 31-32

9. The auditor used the following as the chopsticks calculations:

12/95	2500
1996	30,000

November hearing as "11/9 Tr." and the December transcript as "12/1 Tr."

[2] Taxpayer Ex. Nos. 5A and 5B are sheets of paper purporting to advertise meal specials. However, they are undated and I cannot consider them as applying to the tax period at issue herein. The exhibits cited in this finding of fact are dated within the tax period.

1997	28,000
1/98-6/98	18,560 (determined by averaging)

12/1 Tr. pp. 33-34[3]

10. The proper number of chopsticks purchased by "Casaba" during the tax period is as follows:

12/95	2500
1996	27,500
1997	25,500
1/98-6/98	average to be recalculated

12/1 Tr. pp. 57-63; Taxpayer Exs. No. 1, 2

11. Taxpayer failed to provide the Department with any books or records of any type, other than a box of paper with invoices, during the audit or at any time prior to the hearing. 12/1 Tr. pp.35-36

12. Taxpayer provides chopsticks to its restaurant diners, its carry-out customers, fresh ones are placed into carry home bags with left over food and they are used by the restaurant staff for cooking and for serving. 12/1 Tr. pp. 54-55

Conclusions of Law:

Taxpayer herein is in the business of selling tangible personal property at retail and therefore is subject to the requirements of the Retailers' Occupation Tax Act, 35 **ILCS** 120/1 et seq. (hereinafter referred to as the "ROT" or the "ROTA"). The ROTA requires that every retailer "shall keep records and books of all sales of tangible personal property, together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents." Id. at 120/7 Further, "[a]ll books and records and other papers and documents which are required by

this Act to be kept shall be kept in the English language and shall, at all times during business hours of the day, be subject to inspection by the Department or its duly authorized agents and employees." Id.

In this case, when the Department auditor proceeded with his audit of "Casaba", he was not provided with any books and records. Therefore, he corrected taxpayer's ROT returns according to his "best judgment and information". Id. at 120/4; Fillichio v. Department of Revenue, 15 Ill.2d 327 (1958) This involved multiplying the average meal price by the number of chopsticks purchased, with a 20% allowance for employee meals, etc.

Although the taxpayer was provided with opportunities to present books and records during the administrative proceedings, it failed to do so. At hearing, it presented several menus, one which the auditor used (Taxpayer Ex. No. 10) and one which he did not use because it was not totally in English (Taxpayer Ex. No. 3). "Casaba" also introduced, at hearing, various documents purporting to illustrate that at various times, it offered "Specials" which, for example, discounted meals. The purpose of these documents was to challenge the correctness of the auditor's determination of the average meal price that is crucial to his calculation of liability.[4]

Pursuant to the provisions of the ROTA, the introduction into evidence of the correction of returns prepared by the Department is deemed to be *prima facie* correct and *prima facie* evidence of the correctness of the amount of tax shown to be due therein. 35 **ILCS** 120/4; Fillichio v. Department of Revenue, *supra* "In order to overcome the

[3] Fountain's work papers were neither used at hearing nor otherwise submitted into evidence.
[4] Taxpayer also introduced an agreement with "ABC Restaurant Company, Inc." intending to show additional discounted meals (Taxpayer Ex. No. 5c) However, the testimony regarding this document was

presumption of validity attached to the Department's corrected returns" the taxpayer "must produce competent evidence, identified with their books and records and showing that the Department's returns are incorrect." Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968); Central Furniture Mart, Inc. v. Johnson, 157 Ill. App.3d 907 (1st Dist. 1987); Masini v. Department of Revenue, 60 Ill. App.3d 11 (1st Dist. 1978) Taxpayer does not overcome the Department's *prima facie* case by questioning the Department's correction or returns or merely denying the accuracy of the assessment. Central Furniture Mart, Inc. v. Johnson, *supra*

In this case, the Department auditor went to taxpayer's location several times and requested books, records and other documents. The only documents he was provided were some invoices regarding taxpayer's purchases of chopsticks, which the auditor noted were used at the restaurant tables in lieu of conventional silverware. Due to the lack of documents, he used a readily available menu to calculate an average meal price, multiplied that by the amount of chopsticks purchased and provided for a 20% allowance for such things as ending inventory and meals to employees. Once in these administrative proceedings, taxpayer was again requested to submit documentation regarding its ROT liabilities for the tax period, and again, failed to do so.[5]

At hearing, taxpayer defended against the proposed assessment by claiming that its books and records were not returned by a person who had represented himself to Mrs.

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confusing and I cannot conclude from that testimony that any transactions with "ABC" resulted in discounted meals. 12/1 Tr. pp. 49-51

[5] As previously noted, this hearing commenced on November 9. Because of a concern regarding some discovery, the matter was continued to December 1. On that date, taxpayer appeared with a document described as a book purporting to be a record of taxpayer's daily sales for the tax period. 12/1 Tr. p. 3 By order of August 30, 1999, taxpayer was to "turn over copies of all exhibits it intends to offer at trial for examination by the Department by the close of business on October 18, 1999." This order was acknowledged by taxpayer's counsel. As a result of this order, as well as the fact that the document

"C" as an attorney who could assist taxpayer with its sales tax problems with the Department. 12/1 Tr. pp. 42-46 Mrs. "C's" testimony is the only evidence of this situation.

Next, taxpayer challenges the auditor's determinations by challenging his methodology, attempting to show that his analysis of the average cost of a meal was incorrect. This was done by questioning, *inter alia*, whether he had considered discounted meals, as evidenced by advertised specials, as well as meals discounted by "ABC". The auditor did not consider discounted meals as he was not given any information regarding them prior to the hearing. Further, although there is evidence that taxpayer did discount some meals, there was no information provided regarding the number of meals discounted, nor any information concerning how these discounts specifically impacted on the average meal price used by the auditor. As such, this evidence is insufficient to rebut the *prima facie* correctness of the Department's assessment. See Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App.3d 203 (1st Dist. 1991)

"Casaba" also challenges the audit by questioning whether the auditor correctly accounted for employee give-away meals, by suggesting that there were more employees than the auditor believed there were, and, further, that the "C" family, including children, also ate meals at the restaurant. Again, Fountain testified that he included employee meals, for the number of employees that he saw and reasonably assumed were working at the times he visited the premises, as part of the 20% allowance calculation. Taxpayer never verified the number of employees it had during the tax period, nor was it exact in

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suddenly appeared after not being available at any previous time, the Department's objection to the admission of the document into evidence was sustained.

providing for the numbers of meals eaten by family members during that time. Thus, taxpayer does not rebut the correctness of the Department's assessment with this testimony.

With regard to Fountain's use of chopsticks purchased as part of his assessment calculation, taxpayer elicited evidence that not all chopsticks were used by customers, as the chef and other kitchen and service personnel used chopsticks for food preparation and presentation, as well as for their own meals. Also, not just one set of chopsticks was made available to a customer per meal-that is, if a customer took part of a meal home, a new set of chopsticks was provided. This evidence, however, was not specific as to the number of chopsticks so used, and cannot rise to the level of competency sufficient to discredit the audit.

"Casaba" did, however, introduce into evidence competent documents of the type kept as its own books and records, that shows that the auditor did not take into consideration in his calculation chopsticks returned to "Chopsticks, Inc." For the month of December 1995, Fountain used 2500 chopsticks in his calculation; for 1996-30,000; for 1997-28,000; and for the period through June 30 1998-18,560. 12/1 Tr. pp. 33-34

Taxpayer's Ex. No. 1 is a group exhibit regarding "Chopsticks, Inc." invoices to "Casaba" for chopsticks for 1996. The uncontroverted evidence is that the taxpayer returned one case of 2500 chopsticks to "Chopsticks, Inc." in 1996. 12/1 Tr. pp. 57-60 These returned chopsticks were not eliminated by the auditor from his calculation.

Taxpayer Ex. No. 2 is a group exhibit regarding "Chopsticks, Inc." invoices to "Casaba" for chopsticks for 1997. The uncontroverted evidence is that the taxpayer returned one case of 2500 chopsticks to "Chopsticks, Inc." in 1997. 12/1 Tr. pp. 60-63

These returned chopsticks were not eliminated by the auditor from his calculation. Because the auditor determined the amount of chopsticks used in the first half of 1998 by averaging (12/1 Tr. p. 34), these 5,000 returned chopsticks impact upon the number of chopsticks used in 1998.

Since the number of chopsticks purchased each year is a critical part of Fountain's assessment determination, the reduction in these purchases directly impacts upon the Department's determination of liability. Taxpayer's evidence in this regard rebuts the Department's assessment, and the Department did not overcome this rebuttal. Therefore, the Department's assessment must be amended so as to take into consideration this reduction in the number of chopsticks purchased.

In summation, I find that the auditor's methodology for the calculation of taxpayer's ROT liability for the tax period is reasonable in light of the fact that he was not provided with books and records in spite of affording taxpayer ample opportunity to do so. See 12/1 Tr. pp. 35-36 While it is unfortunate that Mr. and Mrs. "C" have had some financial difficulties, retailers in Illinois are required to abide by the mandates of the ROTA and the courts have not rewarded retailers who have failed to do so.

The Department also assessed a fraud penalty pursuant to §3-6 of the UPIA (35 **ILCS** 735/3-6). In order to sustain a fraud penalty, the Department must prove fraud by clear and convincing evidence. Puleo v. Department of Revenue, 117 Ill. App.3d 260 (4th Dist. 1983) The Department failed to meet this burden, as it remains a possibility that taxpayer chose financial advisors negligently and did not correct difficulties with these advisors using ordinary business care. Based upon the totality of the testimony and other

evidence presented, it is my recommendation that the penalty assessment be revised to reflect that for negligence, as provided in §3-5 of the UPIA (35 **ILCS** 735/3-5).

WHEREFORE, for the reasons stated above, it is my recommendation that the number of chopsticks used by the auditor in his calculations be revised pursuant to this recommendation, and the penalty assessment be revised to reflect one for negligence rather than for fraud, and, as so revised, the assessment set forth in the Notice of Tax Liability at issue be amended to reflect these corresponding corrections to the assessment.

1/11/00

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Mimi Brin
Administrative Law Judge